The Investor's Perspective
Opportunity Zone Investments

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Houston-Galveston Area Council

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Inspired By Trust

"***We exist to serve our clients*** with passionate, powerful, informed advocacy. The trust placed in us inspires us to dig deeper, to never settle, to innovate and negotiate on our clients' behalf. Because we believe the traditional industry is flawed, the trust placed in us drives us to challenge Wall Street's status quo in everything we do. It demands relentless innovation and an unwavering focus on only one thing: delivering complete, global, custom-designed investment solutions to serious investors with serious responsibilities."

- Jon Hirtle, Founder and Executive Chairman
30th Anniversary Letter to Clients

HIRTLE CALLAGHAN

30+ Years of Experience – Since 1988

Only Line of Business is CIO

Conflict-Free and Client-Aligned

Over 200 Client Relationships

Approximately $20 Billion for:

- Endowments
- Foundations
- Healthcare
- Families & Family Offices
- Pension Funds

All data is as of 12/31/18 . Client retention rate is for ten years.

90+ Professionals

96% Client Retention Rate

Independent, Employee-Owned Firm

Headquartered in Philadelphia with Offices in:

- Atlanta
- Baltimore
- Chicago
- Denver
- Louisville
- New York
- Pittsburgh
- Scottsdale
- Houston

QOF Example: Investment Made in 2019

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Annual Return Assumption	10.0%
7 Year Treasury Yield	2.41%
Holding Period	10 Years

Today	Sell Asset	QOF Treatment	Standard Treatment
	Gross Proceeds	$1,200,000	$1,200,000
	Cost Basis	$200,000	$200,000
	Capital Gain	$1,000,000	$1,000,000
	Capital Gains Tax (23.8%)	$0	$238,000
Within 180 Days	Reinvested (basis for OZ investment)	$1,000,000	$962,000
Immediately	Set aside cash for tax	$171,238	$0
Year 7	Pay 23.8% LTCG tax on 85% of original gain	$202,300	$0
Year 10	Sell QOF investment	$2,593,742	$2,495,180
Year 10	Capital gain on QOF	$1,593,742	$1,533,180
Year 10	Tax on QOF investment	$0	$364,897
Year 10	Net proceeds from QOF investment	$2,593,742	$2,130,283
	AFTER TAX CUMULATIVE RETURN	**102%**	**78%**
	ANNUALIZED	**7.3%**	**5.9%**
	Total tax paid	$202,300	$602,897
	Cash outlay for tax	$171,238	$602,897

Levers for Return Enhancement

Delayed payment of taxes

- Lower cash outlay by matching bond maturity to tax payment date
- More capital to invest upfront

Elimination of tax on QOF investment

- Value increased by holding period

Capital gain reduction

Is a 1031 exchange better?

Cumulative Returns Over Ten Years

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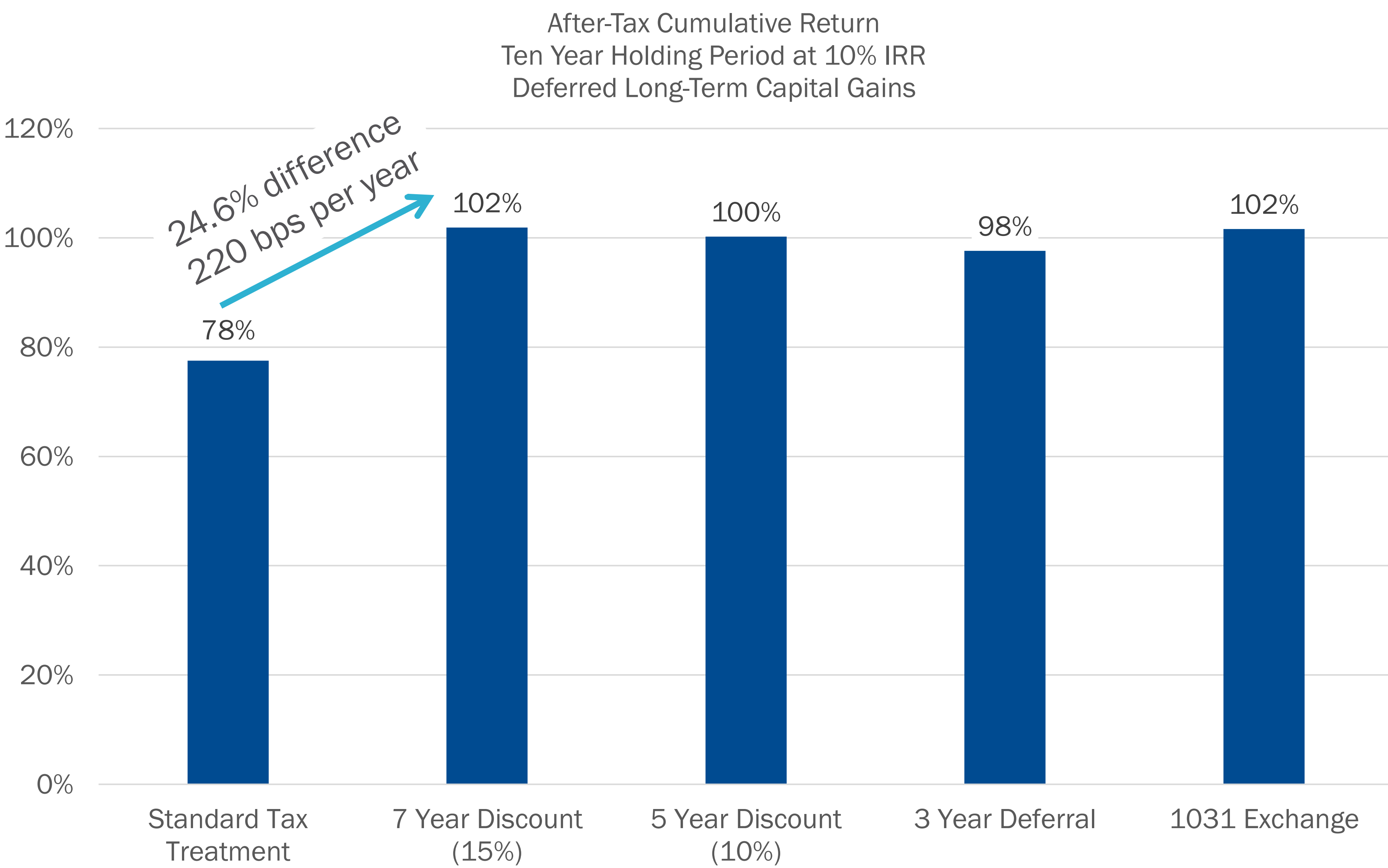

Scenario Analysis

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- Most of the benefit comes from the elimination of gains on the QOF investment
  - Plan to hold QOF at least ten years
  - High net return from capital appreciation
    - Fee drag
    - Cost of required capital improvements for real estate
  - NO RUSH TO COMPLETE BY 2019
    - Take until 2026 to establish QOF

- For real estate investors, a 1031 strategy may be superior
  - Invest full value of asset, not just capital gain
  - Timeline is more advantageous
    - 45 days to identify new property
    - 180 days to close
    - Asset receives step-up in basis at death

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Return Expectations

Fund Flow effect

- Money rushing in now pushes prices up
- All selling at the same time – who's the market then?

Economic cycle

- Analyze investment assuming you will hold it through the next recession
- How will that geography fare in a general recession?

Required improvements to property

- For existing properties, investor must double the value of the building within 30 months

Fees

- Third-party managers charge high management and performance fees
- DIY option requires fees for entity formation and ongoing accounting

Role of QOF equity in project's capital structure

- Ability to refinance, especially if liquidity is needed for 2026 taxes

Reinvestment Risk

- If rental income is distributed out, cannot be reinvested with QOF tax benefits

Portfolio Role

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1. Step-up in basis in a trust
2. Impact Investment Alternative
3. Angel Investments
4. Philanthropy alternative

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Wildcards

- Future changes to capital gains rates or 1031 exchange rules
- Failure to keep compliance with OZ rules or forced early sale
- State tax treatment of gains (may not recognize deferral)
- Ability to complete transaction within 180 days
  - Delays from permitting, construction, weather, labor shortages
- Treatment of long-term leases in OZs

Tax benefits can’t turn a bad deal into a good deal!

What if I own property in an OZ?

Find it on the map:
https://esrimedia.maps.arcgis.com/apps/View/index.html?appid=77f3cad12b6c4bffb816332544f04542

- Sell to a third-party QOF
- A property may qualify if it was acquired from an unrelated party (less than 20% overlapping ownership) after December 31, 2017
- “Recycle” existing property:
  - Sell the property to a QOF where 80% of QOF owners are unrelated parties
  - Must be a cash sale, not a transfer
- Turn property management function into a QOF business investment
- Encourage direct business investments to locate in OZs

Portfolio Diligence Checklist

- ❑ Does the client have experience with illiquid investments?
  - K1s?
  - Infrequent valuation?
  - QP/AI certification for the investing entity?
- ❑ Does the client have an allocation for private/real estate investments?
  - Requires a high risk tolerance
- ❑ Does the client already own property in an OZ that could be sold to an QOF?
  - Run the client's properties through the OZ locator website
- ❑ Does the client have an interest in impact or socially-responsible investing?
- ❑ Is there an attractive 1031 exchange option?
- ❑ Are they comparing the after-tax risk and return correctly?
- ❑ Would the client want to hold this asset through the next recession?
- ❑ Does the client bring unique knowledge about the area where the OZ is located?
- ❑ Does the client have outside liquidity to cover taxes and/or capital improvements?
- ❑ What type of entity should be used (trust, FLP, personal assets)?

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QOF Diligence Checklist

- ❑ Is the fund operated by investors with experience in economic development?
- ❑ Track record of investment team in managing similar assets
- ❑ Was the Fund established specifically for the purpose of investing in OZs?
- ❑ How is the fund maintaining compliance with OZ certification rules?
    - 70% of operating business' property is in the OZ
    - 50% of gross income is from activity in the OZ
    - Real estate is either new or will be improved so basis doubles in value
    - "Sin businesses" ineligible
    - Limited ability to hold cash
- ❑ Diversified fund or per-deal fund?
    - Geographic concentration?
- ❑ Fee structure, incentives, gating, and conflicts of interest?
- ❑ Are the underlying investments at least 90% equity?
- ❑ What is the exit plan? Are there natural buyers for the asset(s)?
- ❑ What support will they provide the CPA and advisors for accurate filing/planning?
- ❑ Who are the other investors in the deal? Where are they in the capital structure?
- ❑ Are marketing materials about investment fundamentals or just tax benefits?

Community Impact Diligence Checklist

- ❑ Infill development versus new development?
  - Reducing vacancy and blight?
  - Displacement effect?
- ❑ Strategic location to build commercial corridor?
- ❑ Local, national, or franchise businesses?
- ❑ Mixed income/affordable housing?
- ❑ Using preexisting community development studies?
  - E.g. Complete Communities plan, Management District Plans
- ❑ Consulting with community development organizations like LISC?
- ❑ Do entrepreneurs keep equity in portfolio companies?
- ❑ For real estate, plan for ongoing affordability after 10 year holding period?

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